

Message Text

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ACTION EA-13

INFO OCT-01 SS-14 ADP-00 NSC-10 NSCE-00 CIAE-00 INR-10

NSAE-00 RSC-01 EB-03 AID-10 OMB-01 TRSE-00 CIEP-02

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FM AMEMBASSY PHNOM PENH

TO SECSTATE WASHDC PRIORITY 2836

C O N F I D E N T I A L PHNOM PENH 9249

LIMDIS

E.O. 11652 GDS

TAGS: EFIN, EAID, CB

SUBJ: IMF, EXCHANGE RATES AND OTHER MATTERS

REF: PHNOM PENH 1809

1. AGREE WITH CHABRIER THAT INITIAL CHANGE IN RATE LESS IMPORTANT THAN WHETERRATE CONTINUES TO MOVE AS IT SHOULD. BUT IF WE READ CHABRIER'S COMMENTS CORRECTLY, HE DOES NOT FEEL RATE HAS MOVED AS IT SHOULD OVER TIME. THE ISSUE AT HAND IS HOW EFFECTIVE THE IMF ROPE HERE IS, AND THE EXTENT TO WHICH WE SHOULD INTERVENE.

2. GIVEN OUR ROLE HERE, CONTRIBUTING (WITH PL 480) OVER ONE HUNDRED MILLION DOLARS A YEAR OF ECONOMIC AID COMPARED TO JAPAN'S SEVEN TO TEN AND THE IMF DRAWING OF SEVEN, WE MUST INTERVENE, AND PER FORCE DISCUSS EXCHANGE RATE ISSUES DIRECTLY WITH THE GOVERNMENT. THAT IS, UNLESS THE FUND REP HERE IS WILLING TO TAKE A STRONGER HAND THAN HE HAS. CLEARLY THE FUND MISSION FELT THE RATE SHOULD HAVE MOVED RIGHT AFTER THEIR MISSION TO 250. AND BY NOW THE RATE SHOULD HAVE BEEN MORE. HENCE OUR 280. EVEN EVERS ADMITS THE DELAY WAS TOO LONG. BUT STILL THE RES REP WENT ALONG WITH THE GOVERNMENT IN DELAYING MOVEMENT UNTIL AFTER THE SUPPLEMENTAL BUDGET WAS THROUGH. MOREOVER WE ARE
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CERTAINLY NOT CONFIDENT THE RATE WOULD HAVE MOVED AT ALL BUT FOR OUR

INTERVENTION. IF THE RATE GETS STUCK AGAIN, AS IS LIKELY, THERE SHOULD BE NO DOUBT WE WILL HAVE TO INTERVENE AGAIN.

3. UNLESS, OF COURSE, WE ARE WILLING TO SETTLE FOR A LOWER RATE OF DEPRECIATION OF THE RIEL THAN OUR ANALYSIS CONCLUDES IS CALLED FOR. FOR EXAMPLE, AS OF NOW, EVERS IS APPARENTLY THINKING OF AN FX RATE OF 300 BY YEAR END. THE KDO STUDY LAST NOVEMBER HAD POSTULATED 320, AND THAT WITH A MUCH SMALLER UNCOVERED BUDGET DEFICIT WITH AMONETARY GROWTH OF 6.2 BILLION, RATHER THAN OUR CURRENT FORECAST OF 9.8 BILLION. WITH INFLATION NOW AT 160 PCT ANNUALLY, AND WITH THE RIEL OVER 400 ON THE BLACK MARKET, A DEPRECIATION OF ONLY 50 PCT FOR 1973 TO AROUND 300 IS INSUFFICIENT IN OUR VIEW.

4. ONE BASIS FOR EVERS DIFFERENT VIEW ON FX RATE IS THAT HE ASSUMES THE FULL 35 MILLION DOLLARES ESF WILL BE USED THIS YEAR. WHEN EVERS SPEAKS OF CARRYOVER, HE REFERES TO AN ADDITIONAL GRANT BY GKR TO ESF LATE THIS YEAR WHICH WOULD BE CARRIED OVER INTO NEXT. PURPOSE OF GRANT IS THAT, ACCORDING TO EVERS CALCUALTIONS, THERE WILL BE AN INCREASE IN GKR RESERVES BY END OF DECEMBER SUFFICIENT TO GRIGGER REPAYMENT REQUIREMENT TO IMF FOR COMPENSATING DRAWINGS. TRANSFER TO ESF WOULD AVOID THAT. WE ARE NOT YET IN A POSITION TO ESTIMATE WITH CONFIDENCE RESERVE POSITION AT END OF YEAR, SO WE CANT SAY WHETHER SUCH INCREASE IS LIKELY. IF SUCH AN INCREASE OCCURS, TRANSFER TO ESF WOULD BE WELL AND GOOD, BUT THAT IS NOT WHAT WE HAVE MEANT BY CARRYOVER. WOULD APPRECIATE CLARIFYING WITH CHABRIER WHAT IS HIS UNDERSTANDING. EVERS ADMITS THAT IF ONLY, SAY, 30 MILLION OF ESF WERE DRAWN DOWN, THAT WOULD ALTER HIS EXCHANGE RATE CALCULATIONS.

5. THE CENTRAL POLICY ISSUE IS WHETHE FX RATE SHOULD BE USED DELIBERATELY TO INCREASE MONETARY ABSORBTION. WE, OF COURSE, BELIEVE IT SHOULD. BUT GKR AND IMF RES REP KEEP PRESSING USE TO INCREASE OUR AID AS MEANS OF INCREASING ABSORBTION. HAD HOPED THIS OLD REFRAIN HAD GONE THE WAY OF 78 RPM RECORDS. AN IMPORTANT FACTOR IN OUR THINKING WHICH, INSOME DEGREE, DIFFERENTIATES OUR VIEW FROM BOTH THE GKR AND THE IMF HERE IS THAT WE PEER AHEAD WELL INTO 1974. THERE IS ATENDENCY ON THEIR PART TO VIEW THE 1973 MONETARY PROGRAM IN ISOLATION. WE VIEW IT IN TERMS OF A CONTINUING MATTER, AND THIS MAKES US CONCERNED WITH FX RATE MOVEMENT FOR FUTURE
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ABSORBTION.

6. ONE STRATEGY ISSUE IS WHETHER THE RIEL SHOULD DEPRECIATE AT A RATE GREATER THAN THE RATE OF MONETARY INCREASE. THE KDO STUDY POSTULATED SUCH A STRATEGY AS A WAY TO SQUEEZE OUT EXCESS LIQUIDITY. THIS REALTES TO THE QUESTION OF WHETHER THE MONETARY INCREASE OF 50-60 PERCENT THE FUND SEEMS TO BE THINKING OF IS BEARABLE. IN OUR VIEW, THE PRESENT SITUATION, IT WOULD BE DISASTROUS. AND ALL

THE MORE SO SINCE IT IS NOT NECESSARY FOR THE RIGHT MEASURES CAN
AVOID IT. BELIEVE IT SHOULD BE BORNE IN MIND THAT AN INFLATION
RATE OF SEVERAL HUNDRED PERCENT, EVEN A THOUSAND PERCENT, IS NOT
OUT OF THE QUESTION AT ALL. THIS MAKES IT IMPERATIVE THE FUND AND
WE WORK TOGETHER AND ABOVE ALL NOT PROVIDE THE GKR WITH CONFLICTING
ADVICE. GKR HAS ENOUGH PROBLEMS WITHOUT THAT. HOWEVER, THIS
REQUIRESTHE IMF HERE, NOT JUST US, ADHERE TO THE MOTION THAT LIFE
IS A TWO-WAY STREET, EVEN WITH REGARD TO THE EXCHANGE RATE.
SWANK

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